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Takeaways From Cumulus Media Refinancing Ruling

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A recent decision by the U.S. District Court for the Southern District of New York in Cumulus Media Holdings Inc. v. JPMorgan Chase Bank NA (SDNY Feb. 24, 2017) found that a proposed refinancing that was consented to by the company's revolving credit lenders nevertheless violated the negative covenants in the company's credit agreement.


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The Proceedings

Cumulus had proposed a series of transactions that would have resulted in the exchange of $610 million of its senior notes due 2019 for $305 million of new debt under its revolving credit facility. More specifically, the company proposed that (1) the existing lenders under the revolver would assign their revolver commitments to the holders of the senior notes, (2) those holders and the company would amend the credit agreement, including loosening the leverage ratio in order to permit the company to access $200 million of availability under the revolver, (3) the holders of the senior notes would fund a $105 million incremental revolver facility, and (4) the company would draw on the $305 million of availability under the revolver to retire the senior notes.

When the credit agreement agent indicated that it might not consent to the transactions, the company commenced an action seeking a declaratory judgment that the proposed restructuring complied with the credit agreement.

Issues in Dispute

The agent responded, and an ad hoc group of term lenders under the credit agreement intervened, asserting that the proposed prepayment of the senior notes breached the restricted payment covenant in section 8.8 of the credit agreement. That covenant generally prohibited the company from redeeming or purchasing or making any optional payment or prepayment on the senior notes or any "permitted refinancing" of the senior notes, but included a carveout for payments "in connection with *any refinancing* of the Senior Notes or any Permitted Refinancing thereof permitted pursuant to the terms hereof ..." (emphasis added). The reference to "any refinancing" permitted pursuant to the terms of the credit agreement, the agent and term lenders argued, meant only a permitted refinancing. The company, on the other hand, contended that it could refinance the senior notes with any debt permitted by the credit agreement, including the proposed borrowings under the revolver.

The agent and the intervening lenders also challenged the amendments to the credit agreement. The company had obtained the requisite consent of the revolver lenders to the amendments, and the amendments did not require the consent of the term loan lenders. But the agent and the intervening term lenders declared that the proposed amendments would adversely affect the interests of the term loan lenders by burdening the company with $305 million of additional first-lien debt at a time the lenders were undersecured. This, they asserted, violated section 8.16, which prohibited the company from amending "any indenture, credit agreement or other document ... in each case except for any such amendment, modification or waiver that (i) would not, in any material respect, adversely affect the interests of the Lenders and (ii) would otherwise not be prohibited" under the Credit Agreement.

The Court's Ruling

Judge Katherine Polk Failla, whose ruling regarding Section 316(b) of the Trust Indenture Act was recently overturned by the U.S. Court of Appeals for the Second Circuit, did not rule on whether the refinancing of the senior notes violated the restricted payment covenant. Instead, she focused on the debt covenant, specifically the basket in section 8.2(h) that permitted the company to incur "the Senior Notes ... and any Permitted Refinancing thereof."

Rather than interpreting the reference to "any Permitted Refinancing" of the Senior Notes as permissive, the court found it to be limiting, holding that "[t]his language limits the senior note indebtedness in plain terms. Cumulus may bear indebtedness derived only from any permitted refinancing of the senior notes, not any refinancing thereof."

Thus the court concluded that even though the debt covenant permitted the company to borrow under the revolver, it could not use the proceeds of these borrowings to refinance the senior notes unless the refinancing qualified as a permitted refinancing, and the court further held that the proposed refinancing failed in this regard.

Pursuant to the credit agreement, new debt could qualify as a permitted refinancing only if, among other things, (1) it matured later than (or on the same date as) the refinanced debt, and (2) to the extent the liens securing the refinanced debt were subordinated to the liens securing the obligations under the revolver, the liens securing the refinanced debt were subordinated to the same extent.

Noting that the new loans under the revolver, to the extent provided by existing revolving lenders that opted not to assign their commitments to the holders of the senior notes, would mature in 2018, earlier than the maturity date of the senior notes, the court found that the new loans failed the first test. The court found that the new debt also failed the second test because it would be secured by a first lien, whereas the debt being refinanced was unsecured.

Finally, the court found that the proposed amendments to the credit agreement would adversely affect the term lenders because the draws on the revolver would force them to share collateral with the revolver lenders at a time that the term lenders were undersecured. As a result, the court held that the amendments violated section 8.16 of the credit agreement, notwithstanding the fact that the company had complied with the credit agreement's amendment provisions.

Takeaways

Investors should anticipate that creditors may rely on two aspects of the Cumulus decision to challenge other exchange offers, particularly those in which issuers seek to refinance unsecured debt with secured debt.

First, the court in Cumulus surprisingly construed the reference to permitted refinancing to be restrictive. It is not uncommon for debt baskets, especially those in credit agreements, to include permitted refinancings of the debt in question, and typically such references are considered to be permissive and to afford the company flexibility. The court in Cumulus, however, found that the reference to permitted refinancing in the basket that permitted the senior notes was limiting, and held accordingly that the inclusion of that term meant that the company could not incur debt to refinance the senior notes unless that debt constituted a permitted refinancing. Depending on the facts of the case, it may be possible to distinguish Cumulus based on the restricted payment covenant in the credit agreement that generally prohibited prepayments of the senior notes, but it is noteworthy that the court did not rely on this covenant in reaching its conclusion.

Second, in holding that the proposed transactions did not qualify as a permitted refinancing, the court found that the liens securing the new debt under the revolver were not subordinated to the credit agreement liens on terms at least as favorable to the lenders as the liens securing the debt being refinanced. The court reached this conclusion notwithstanding the fact that the plain language of this portion of the definition of permitted refinancing applied only to refinancings of debt that were already secured by liens. Thus, Cumulus provides ammunition to creditors seeking to challenge exchange offers in which unsecured debt is refinanced with secured debt.

The court’s finding in Cumulus that the proposed amendments to the credit agreement adversely affected the term lenders and therefore violated section 8.16 is less likely to be relevant in other credits due to the nature of that provision. Credit agreements typically do include similar covenants that prohibit amendments to certain documents to the extent those amendments would adversely affect lenders. The documents that are covered by these covenants usually consist of junior financings, organizational documents and other material agreements, but not credit agreements. As a result, one would expect this aspect of the Cumulus holding to have limited effect.

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